No. 15,456

IN THE

United States Court of Appeals

For the Ninth Circuit

JOSEPH L. JOY, Trustee of the Estate of Miller Scraper & Mfg. Co., Inc., Bankrupt,

Appellant,

vs.

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION AND CONSOLIDATED DISTRIBUTORS, INC., a corporation,

Appellees.

APPELLANT'S OPENING BRIEF.

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STATEMENT OF JURISDICTION.

The Bankruptcy Receiver filed his Petition for rder to Show Cause, to Show Nature, Extent and alidity of Alleged Lien (Tr. pp. 7-8) and Consoli- ated Distributors, Inc., and Bank of America N.T. S.A. were ordered to show and establish the amount nd validity of their liens upon assets of the bankrupt orporation (Tr. p. 9). The Bankruptcy Referee en- red an Order (Tr. pp. 11-17) determining that either Consolidated Distributors, Inc., or Bank of merica N.T. & S.A., had any right, title or interest i the 42 scrapers described in Exhibit "A" attached his Order. Petitions to Review the Order of the

Referee were filed by Consolidated Distributors, Inc., and Bank of America N.T. & S.A. The District Court (Tr. pp. 32-38) affirmed the Order of the Referee determining that Consolidated Distributors, Inc., had no right, title or interest in any of the 42 scrapers and reversed the Order of the Referee adverse to Bank of America N.T. & S.A. Pursuant to the provisions of 11 U.S.C.A. 47, Appellant filed his Notice of Appeal *only* from that portion of the District Court Order reversing the ruling of the Referee adverse to Bank of America N.T. & S.A. No appeal was taken by Consolidated Distributors, Inc., from the Order of the District Court adverse to it.

STATEMENT OF QUESTION PRESENTED.

May a holder of Trust Receipts upon property described therein, whose alleged secured interest was acquired from a Vendee having no valid title, take the property from the Bankruptcy Trustee of the Vendor?

STATEMENT OF FACTS.

Miller Scraper & Mfg. Co., Inc., a corporation, the bankrupt, hereinafter referred to as "Miller", had been engaged in manufacturing road scrapers and farm equipment. On March 20, 1952 its predecessor entered into an agreement (Tr. pp. 191-204) to sell his entire output or production of scrapers manufactured by him to Industrial Equipment Co., Inc., a corporation, subsequently known as Consolidated Distributors

Inc., a corporation, hereinafter referred to as "Consolidated", and said agreement was amended and supplemented by an agreement (Tr. pp. 204-213) dated April 4, 1952. Paragraph 3 of the agreement dated March 20, 1952, as amended (Tr. p. 207) provided that all scrapers were "to be delivered to the Distributor F.O.B. Carrier, at Selma, California, or are to be stored and/or warehoused at the Yard of the Manufacturer at the direction of the Distributor, and that, in either event, title thereof shall pass to the Distributor upon the occurrence thereof." During June, 1952, Consolidated set up a selling organization and established an office in a portion of a small office building occupied by Miller on a four-acre tract of land upon which Miller had its plant for manufacturing the scrapers. Upon completion of each scraper it was moved to an unfenced, open area on a portion of the premises located about the center of the four-acre tract set aside for this purpose. Each scraper was immediately inspected by Consolidated and was accepted or rejected, depending upon whether mechanical defects were discovered.

On the 1st and 15th of each month invoices were received by Consolidated direct from Miller, which Consolidated attached to a Trust Receipt which was delivered by Consolidated to Bank of America N.T. & S.A., a corporation, hereinafter referred to as "Bank". Immediately upon delivery of the Trust Receipt to Bank, the account of Miller at Bank was credited to a sum equal to 90% of the invoice price of each scraper listed upon the Trust Receipt. Between

July, 1952 and September, 1954 a representative of Bank made monthly inspections of the scrapers situated on the above-mentioned open, unfenced area, and knew that all scrapers were intermingled with other equipment of Miller. In June 1953 Consolidated moved its offices, vacating the Miller premises and leaving the scrapers in the latter's possession and control. At all times thereafter until Bankruptcy, the scrapers remained in the sole and exclusive possession of Miller. When Miller was adjudicated a bankrupt there were about 42 scrapers which came into the possession of Appellant Bankruptcy Trustee, described in Trust Receipts held by Bank, located on the aforesaid site. Consolidated and Bank claimed possession of all scrapers.

Upon a Petition of the Bankruptcy Receiver filed with the Bankruptcy Referee the latter issued his Order requiring Consolidated and Bank to establish the nature, amount, extent and validity of any claim against the bankrupt and of any lien claim or security upon the assets of the bankrupt estate. Following lengthy hearings the Referee in his Order Determining Nature, Extent and Validity of Claims to Personal Property (Tr. pp. 11-16) included as one of his Findings that an employee of Bank making monthly inspections saw that the scrapers were intermingled with other equipment of the bankrupt. The Referee concluded as Matters of Law that (1) the title asserted by Consolidated in the scrapers was void because there had been no immediate and continued change of possession of all scrapers by Consolidated pursuant to

California Civil Code Section 3440, and (2) that since Bank at all times had knowledge of lack of change of possession it was estopped from claiming any better title than Consolidated. Consolidated and Bank filed Petitions to Review the Order of Referee. His decision was affirmed by the District Court as to Consolidated and reversed as to Bank. (Tr. pp. 32-38.)

ARGUMENT.

I.

THE DISTRICT COURT ERRED IN FAILING TO AFFIRM THE FOURTH AND SEVENTH FINDINGS OF FACT OF THE BANKRUPTCY REFEREE.

(a) Fourth Finding of Fact.

Both documentary (Tr. p. 207, lines 1-20) and oral (Tr. p. 91, lines 17-31 and p. 92, line 18) evidence introduced at the hearing before the Bankruptcy Referee support his Fourth Finding of Fact (Tr. p. 13, lines 14-29) of the purchase of the scrapers by Consolidated from Miller and the alleged security interest under the Trust Receipt being derived by the Bank from Consolidated. Nevertheless, the District Court disregards this positive evidence that the security evidence of the Bank flowed from Consolidated and held that the alleged security interest of the Bank was not a derivative interest because the invoices were made direct to the Bank. This practice was merely a matter of form only, as is shown by the evidence that the invoices were turned over by Miller to Consolidated to be attached to Trust Receipts prior to delivery to the Bank. Since, under amended paragraph 3 of the Agreement of Sale

(Tr. p. 207, line 20) between Miller and Consolidated, title to the scrapers was to pass direct from Miller to Consolidated upon delivery, storage and/or being warehoused, the invoices were delivered direct to Consolidated and not to the Bank, and it clearly appears from the testimony of the President of Consolidated (Tr. p. 92, lines 15-18) the alleged security interest of the Bank came into being at the moment the Trust Receipts were delivered to the Bank, at which time Consolidated then became trustee for the Bank. The Bank, in fact, was not even aware of the transaction, nor in any way responsible to Miller, until such time as Consolidated executed and delivered the Trust Receipts to the Bank.

The evidence clearly supports the Fourth Finding of Fact of the Bankruptcy Referee that Consolidated purchased the scrapers from Miller, and his Conclusion of Law that the sale being void, the Bank could not obtain any title which Consolidated failed to acquire. The District Court, in holding that the alleged security interest of the Bank was acquired from Miller against the evidence which conclusively proves that Miller agreed to transfer title to Consolidated, erred in failing to affirm the Fourth Finding of Fact of the Bankruptcy Referee.

(b) Seventh Finding of Fact.

The District Court, in failing to affirm the Seventh Finding of Fact of the Bankruptcy Referee (Tr. p. 15, lines 8-14) and holding the Bank acquired its alleged security interest from Miller and not from Consoli-

dated, disregards the undisputed evidence of knowledge of the Bank by means of monthly inspections (Tr. p. 178, lines 27-31, and p. 179, lines 1-5) that the scrapers were intermingled at all times with other assets of Miller, the bankrupt. The Bank therefore had knowledge of lack of possession by Consolidated, from whom it received its Trust Receipts, and it is not the purpose of the law of Trust Receipts to permit any holder of a Trust Receipt to assert a valid security interest in property which is not in the possession of the person executing the Trust Receipt, known as the Trustee. How can it be said that Consolidated is a Trustee of the Bank when it lacked possession of the scrapers described in the Trust Receipts, and the Bank, under the Seventh Finding of Fact of the Bankruptcy Referee, knew the same were located on the premises of Miller, the bankrupt, intermingled with other assets? This Seventh Finding of Fact is incorporated in the Conclusions of Law of the Bankruptcy Referee, to wit: "the Bank of America NTSA was aware at all times of the facts concerning said lack of change of possession" (Tr. p. 16, lines 6-8). The District Court therefore erred in failing to affirm the Seventh Finding of Fact of the Bankruptcy Referee, thus validating the Trust Receipts which the Bank received direct from Consolidated with full knowledge at all times that "from 1952 to December of 1954 * * * saw that said scrapers were intermingled with other equipment of the above bankrupt and *located on the premises of the above bankrupt.*" (Emphasis added.) (Tr. p. 15, lines 11-14.)

II.

THE DISTRICT COURT ERRED IN OVERRULING THE CONCLUSION OF LAW OF THE BANKRUPTCY REFEREE OF ESTOPPEL AGAINST THE BANK.

The Bankruptcy Referee concluded, as a matter of law (Tr. p. 16, lines 8-11) that the Bank was estopped from claiming any better title than Consolidated because the Bank had knowledge at all times of the lack of change of possession. This Conclusion of Law is based upon the Seventh Finding of Fact of the Bankruptcy Referee discussed in the preceding paragraph and based upon actual knowledge of the Bank during its monthly inspection that the scrapers described in the Trust Receipts were always "located on the premises of the * * * bankrupt." (Tr. p. 15, lines 13-14.)

The Bank could have insisted that all of the scrapers be separated from other property of the bankrupt and moved to another area on the four-acre tract and surrounded by a fence with a sign or signs reading "Property of Consolidated Distributors, Inc." Had the Bank demanded that the practice of Consolidated approving and consenting to the continued intermingling of its scrapers with property of the bankrupt cease and the scrapers kept within an enclosed area at all times, creditors of the bankrupt corporation, whom Appellant Trustee represents, would have been apprized of property being located on the premises of the bankrupt belonging to Consolidated. The continued intermingling of the scrapers gave no notice that the same had been sold to and were owned by Consolidated.

Furthermore, merely because the Bank had complied with the provisions of the Trust Receipts Act gave no notice to creditors of the bankrupt that the intermingled scrapers owned by Consolidated were subject to Trust Receipts held by the Bank. Only Consolidated, as Trustee, and the Bank as Entruster, would appear in the Statement of Trust Receipt Financing filed with the Secretary of State, and any creditor making inquiry of his office would find no record of the Bank financing any Trust Receipt transactions of the acquisition of scrapers by Consolidated from Miller, the bankrupt. To permit the Bank to claim the scrapers in the possession of Appellant Bankruptcy Trustee by virtue of its Trust Receipts would enable the Bank to enforce what amounts to a secret lien on all of the scrapers. Such action would be contrary to the statement made by this Court in *Stepp v. McAdams* (9 CA) 88 F. (2d) 925, and on page 928 the Court said:

> "*The law frowns upon secret charges against property.* It is well established that equitable liens will not be enforced against creditors without notice, either actual or constructive." (Emphasis added.)

The District Court therefore erred in the pending matter by overruling the Conclusion of Law of the Bankruptcy Referee that the Bank is estopped from claiming any better title than Consolidated has validated a secret lien of the Bank on the scrapers intermingled at all times with property of Miller, the bankrupt.

III.

THE DISTRICT COURT ERRED IN HOLDING THE INTEREST OF THE BANK WAS NOT DERIVATIVE FROM CONSOLIDATED.

Heretofore, in Paragraph I, Appellant Trustee has discussed the provisions of amended Paragraph III (Tr. p. 207, lines 1-20) of the Sales Agreement between Miller and Consolidated providing for the passage of title to the scrapers *direct* from Miller to Consolidated. The attention of this Honorable Court was directed to the procedure followed (1) by Miller delivering all invoices *direct* to Consolidated and not to the Bank; (2) Consolidated then attaching the invoices and Trust Receipts and delivering them to the Bank, and (3) the alleged security interest of the Bank coming into being *at the time of each delivery.* (Tr. p. 92, lines 9-18 and p. 120, lines 9-12.) The documentary and oral evidence clearly supports the decision of the Bankruptcy Referee that the invalid security interest of the Bank was derivative from Consolidated and not from Miller, and the District Court clearly erred in holding that the title and interest of the Bank was not derivative from Consolidated. (Tr. p. 37, lines 20-22.)

Since a Trust Receipt is similar to a Chattel Mortgage in that a security interest is transferred for the purpose of securing an obligation to repay money, the general rule relating to the requirement that the validity of a Mortgage must depend upon the validity of the title of the mortgagor also applies with respect to the necessity of valid title being vested in the owner of property upon which it executes a Trust Receipt, the following general rule relating to Chattel Mort-

gages is clearly applicable to Trust Receipts; it is stated in 14 C.J.S., on page 614, that "a chattel mortgagor can convey by mortgage only that interest which he possesses in property"; and on page 615, "it is the duty of the mortgagee or his assignee to see that the mortgagor has good title to the property which he undertakes to mortgage."

In *Winchester Packing Co. v. Moyer, et al.,* (Kansas Supreme Court), 187 Pac. Rep., 680 the facts disclose that a stock of goods and fixtures were sold without compliance with the Bulk Sales Act and the buyer executed a chattel mortgage on the fixtures as security for money borrowed to pay the purchase price. The Court held that the mortgage was void because of the invalid title to the fixtures upon which the mortgagor (the buyer) executed a mortgage. On page 681 the Court said:

> *"But, as its title could rise no higher than its source, Phillips, and as Phillips had no right whatever to use the property to secure the bank, so also the bank had no right as against existing creditors to look to such property for security.* Under the statute (Gen. Stat. 1915 § 4894) the sale was void as to existing creditors who had the same right to proceed against the property as if it were still held by Moyer. *Hence, the source of the bank's title failing, it must step aside for the plaintiff,* whose claim is substantially larger, than the amount realized from the sale under the levy." (Emphasis added.)

In *Ballou v. Andrews Banking Co.,* 128 Cal. 562, the facts disclose that there was a transfer of personal

property within one month prior to the commencement of insolvency proceedings and not in the usual and ordinary course of business. The facts further disclose that after the property had been transferred to Schwartz he subsequently transferred a portion of the property to the defendant which had knowledge of the previous invalid transfer to Schwartz. The Supreme Court affirmed the decision of the lower Court, holding that the plaintiff, as assignee for the benefit of creditors of the original transferor, was entitled to the value of the assets transferred to Schwartz and subsequently transferred to defendant, and on page 566 said:

> *"In any event, under the circumstances, the transfer to Schwartz being void, the defendant took no greater title than Schwartz had."* (Hobart v. Tyrrell, 68 Cal. 12; Brown v. Bank of Napa, 77 Cal. 544.)" (Emphasis added.)

In *Brown v. Bank of Napa,* 77 Cal. 544 there was a transfer of personal property by Reed to Chapman without any change of possession. Subsequently, the defendant, Bank of Napa, had the property transferred to it. The Court found that the bank had notice of the invalidity of Chapman in the title to the property which Reed had transferred to him and affirmed the judgment in favor of the plaintiff as assignee of insolvency of Reed to recover damages from the defendant bank for conversion of the property. On page 547 the Court said:

> "But such purchaser or encumbrancer must show his good faith by parting with his money, or

money's worth, on acquiring the property *without notice of any infirmity in the vendor's title.* We are of opinion that *the evidence shows that the bank had notice of the infirmity of Chapman's title,* and it is in effect so found." (Emphasis added.)

In *Della v. Home Bank of Porterville,* 105 Cal. App. 106, the facts disclosed a violation of California Civil Code Sec. 3440 because of absence of actual and continued change of possession. In affirming judgment for the plaintiff against the defendant bank, the Court, on page 109 said:

"There is no question in this case that there was no immediate or continued change of possession of the cattle from Shepard to the bank and that the attempted sale to the bank was fraudulent and void as to the other existing creditors of Shepard. *The attempted sale must be treated as though it had never taken place* and the bank must be regarded as holding the money it received from the sale of the cattle, in trust for the benefit of the creditors of Shepard. (Allee v. Shay, 92 Cal. App. 749 (268 Pac. 962).)" (Emphasis added.)

In *Renaldi v. Goller,* 48 Adv. Cal. Rep. 273, the lessees of vacant property gave a chattel mortgage on a building to be constructed thereon to secure funds borrowed for its erection from one Goller. About three years later the lessees abandoned the leased property upon which the building had been erected and subsequently plaintiffs, the owners, sued the lessees and the mortgagee, Goller, to quiet title to the premises. The California Supreme Court in affirming the Judgment

for plaintiffs in the lower Court held that the lien of the mortgagee was *derivative* from the lessees and his right or title was based upon whatever interest the lessees had in the property and building when mortgagee asserted his claim. On page 279 the Court said:

> "The rights of the chattel mortgagee *are derivative.* He cannot assert a greater right against the lessor than can the lessees. A mortgagee from a tenant has no greater right to remove trade fixtures from the premises after the tenant has surrendered possession to the landlord than the tenant himself would have. *Whatever right or title the mortgagee from the tenant may have cannot rise higher than its source,* and is measured by what the rights of the tenant would be at the time the mortgagee asserts his claim." (Donahue v. Hardman Estate, 91 Wash. 125, 128 (157 P. 478).) (Emphasis added.)

So, in the pending appeal, the rights of the Bank are derivative from Consolidated, the Trustee, under the Trust Receipts. Whatever right or interest the Bank may have cannot rise higher than its source, to wit, the title of Consolidated in the scrapers described in the Trust Receipts. Since the District Court affirmed (Tr. p. 36, lines 7-11) the Order of the Bankruptcy Referee (Tr. p. 16, lines 15-19) holding that Consolidated had no right, title or interest in the scrapers the derivative security interest of the Bank under its Trust Receipts of Consolidated is consequently void.

IV.

THE DISTRICT COURT ERRED IN ITS CONCLUSION OF LAW THAT THE INTEREST OF THE BANK IS VALID AS AGAINST APPELLANT TRUSTEE AND THE CREDITORS OF THE BANKRUPT ESTATE.

Appellants' Fourth Assignment of Error follows from that considered in the previous Section of the within Brief, but is directed to the Conclusion and Order of the District Court validating the Bank's title as against Appellant, which conclusion, Appellant submits, is contrary to law and unsupported by the facts.

The Referee concluded that there was no immediate or continued change of possession of the scrapers from Miller to Consolidated, or any other person, as required by Section 3440 of the California Civil Code. He therefore decreed that the sale from Miller to Consolidated was void and that Consolidated had no right, title or interest in the scrapers.

The District Court affirmed the Referee's Findings of Fact and Conclusions of Law relating to the right, title and interest of Consolidated in the scrapers. Thus it has been decided that, as between Miller and Consolidated, compliance with Civil Code Section 3440 was required and was not met and that, therefore, the sale between Miller and Consolidated was null and void.

The reviewing Judge indicates, however, that the foregoing facts are of no consequence and that the rights of the parties are controlled by the language in Section 3014 of the California Civil Code, to wit:

> "The security interest of the entruster may be derived from the trustee or from any other person,

and by pledge or by transfer of title or otherwise."

The following analysis of the foregoing Code Section and the authorities cited by the District Court clearly demonstrate the error complained of by Appellant Trustee.

(a) Analysis of the Chichester Case.

In the discussion that follows the factual situation is as follows: Miller is the manufacturer-seller and Consolidated is the financed-purchaser as well as Trustee under the Trust Receipts executed with the Bank. The Bank financed the purchase of the scrapers by Consolidated from Miller *upon* delivery of the Trust Receipts naming the Bank as Entruster.

The District Court relied on *Chichester v. Commercial Credit Co.,* 37 C.A. 2d 439 (1940), to uphold its decision that the Bank has a valid security interest in the scrapers.

In the *Chichester* case Reagan was a retail automobile dealer selling Chrysler and Plymouth automobiles. Defendant, Commercial Credit Co., financed the purchase of automobiles placed on Reagan's floor, who, to obtain Plymouth cars, executed Trust Receipts and signed promissory notes in favor of Commercial Credit Co. The latter *then* ordered the automobiles *delivered to Reagan's place of business.* To obtain Chrysler cars, Reagan placed his order with the Chrysler Corporation in Detroit, Michigan. Commercial Credit Co., the Defendant, paid the purchase price to Chrysler and *then*

he *automobiles were shipped to Reagan.* The Bills of Lading were made out to and *sent directly* to Defendant. Reagan *then* signed Trust Receipts and promissory notes in favor of Defendant and Defendant *then* turned over the Bills of Lading to Reagan who *took delivery of the automobiles.* Defendant repossessed the automobiles just prior to Reagan filing his Petition in Bankruptcy. The facts of the *Chichester* case show clearly that the automobile dealer, Reagan, was a financed-purchaser as Consolidated was in our case. The Chrysler Motor Company was the manufacturer-seller as Miller was in our case. Here the similarity between the *Chichester* case and the pending appeal ends.

The following distinctions should be noted:

a) The bankrupt in the *Chichester* case was Reagan, the financed-purchaser. The bankrupt in the pending matter is Miller, the manufacturer-seller.

b) The financed-purchaser in the *Chichester* case obtained *actual possession* of the automobiles from the manufacturer-seller at his place of business, *which was distinct and separate from the manufacturer-seller.* The sale to the financed-purchaser from the manufacturer-seller was deemed to be a valid sale. In our case the Referee and the District Court have both found that Consolidated, the financed-purchaser, *did not obtain actual possession* of the scrapers and that the sale from Miller, the manufacturer-seller, to Consolidated, the financed-purchaser, was null and void for want of compliance with Section 3440 of the California Civil Code.

The Trustee in Bankruptcy in the *Chichester* case contended that title to the automobiles never vested in the defendant-financer and that the so-called "Trust Receipt" transaction between Reagan, *the financed-purchaser, and the financer was a chattel mortgage* which was void for failure to comply with the provisions of Civil Code Section 3440 relative to recordation. The Court pointed out in the *Chichester* case that in Trust Receipt transactions the Entruster does not have possession of the goods. Citing *Arena v. Bank of Italy,* 194 Cal. 195, the *Chichester* opinion points out (page 443):

> "Prior to the adoption of the Uniform Trust Receipts Law, *the only instance where the security title of a trust receipts holder was permitted to prevail against the claims of creditors of the trustee, or against his trustee in bankruptcy,* was where the title of the entruster or trust receipt holder was derived from someone other than the trustee. Where the title of the entruster was derived from the trustee and not some third person, the transaction was treated as being similar to a chattel mortgage and was held to be void as against creditors of the trustee in the absence of recordation."

The Court said that the defendant-financer received its title directly from a third person; to wit, the Chrysler Corporation, and was, therefore, protected under the prior law as set forth in the *Arena* case, as well as under the present law embodied in the Civil Code Section 3014 (1) (b) (ii) which reads in part as follows:

> "The *security interest* of the entruster may be derived from the trustee or from any other person . . ."

There was no evidence to prove that the financed-purchaser, at any time prior to signing the Trust Receipt, had either title to or possession of any of the automobiles in question. The Court then stated that it made no difference whether title of defendant originated with the Chrysler Corporation or with the financed-purchaser. On page 445 of the decision the Court states the nature of the title that an Entruster receives in a Trust Receipt transaction:

> "Under the existing law, by which the instant case is to be governed, the entrusters *security interest* will be protected whether his title is derived from the trustee or from a third party."

The *Chichester* case held, among other things, that it was not necessary for a Trust Receipt transaction *between the financed-purchaser and the financing company* to comply with Civil Code Section 3440, and that such Trust Receipt, though not complying with Section 3440, *would not be void as against the creditors of the financed-purchaser.*

b) The Chichester Decision Is Not Applicable to the Facts as They Exist in the Case at Bar.

Appellant Bankruptcy Trustee has no quarrel with the decision in the *Chichester* case as it applies to the particular facts of that case. However, it is respectfully submitted that the District Court has misunderstood and misapplied the *Chichester* case by attempting to apply the Decision as an abstract rule of law to an entirely different set of facts. It is respectfully submitted that Appellant Trustee in Bankruptcy is entitled to have the law applied to facts as they exist in

the pending matter on appeal and not to the facts as found in the *Chichester* case. It is important to note, as pointed out above, that it is Miller, the manufacturer-seller, that is the bankrupt in the case at bar and not Consolidated, the financed-purchaser, as in the *Chichester* case and, therefore, we are concerned here with the claims of the creditors of Miller, the manufacturer-seller, and not with the claims of the creditors of Consolidated, the financed-purchaser. Would the *Chichester* decision have been the same if the Chrysler Corporation had been the bankrupt, if Consolidated had done business on the same premises with the Chrysler Corporation and there had been *no valid sale or change of possession* as between Chrysler and Consolidated? Could the Bank of America then claim a security interest as against the Trustee in Bankruptcy for the Chrysler Corporation? This is exactly the factual situation in the case at bar.

The District Court mentions Civil Code Section 3014 (1) (b) (ii) which provides that the *security interest* of the entruster may be derived from the trustee or from any other person. This Code Section applies in a normal Trust Receipt transaction where there is *a valid sale* and an actual *change* of possession between the manufacturer-seller and the financed-purchaser. The Entruster can then receive his security interest either directly from the manufacturer-seller or from the financed-purchaser and, as pointed out in the *Chichester* case, it is not necessary that the financed-purchaser have either title or possession of the property prior to the execution of the Trust Receipts, nor

hould it be since ordinarily the execution of Trust Receipts is the method by which the financed-purhaser acquires possession of the property. However, *he validity of the security title* that the Entruster eceives upon execution of the Trust Receipts is deendent upon *a valid sale* and an actual change of ossession between the manufacturer-seller and the nanced-purchaser. The Trust Receipt document has he effect of giving a security interest in the property f the financed-purchaser and not in the property of he manufacturer-seller. This is by virtue of the fact hat the real parties to the Trust Receipt document re the Entruster, the financing company, and the 'rustee, the financed-purchaser. Therefore, if no valid ale has ever been consummated between the manufacurer-seller and the financed-purchaser and the latter ever obtains possession of the property subject to sale here exists no title in property of the financed-purhaser upon which the financing company can base any ecurity interest. Granted, that once a valid sale has een made between the manufacturer-seller and the nanced-purchaser and the financed-purchaser *obtains ossession of the property* as Reagan, the bankrupt, id in the *Chichester* case, it would not then be necesary for the financed-purchaser and the financing comany to comply with Section 3440 of the California ivil Code after compliance has already been made ith the Trust Receipt sections of the Civil Code. So he holding of the District Court that the Entruster's ecurity interest may be derivative from a Trustee or third party is admitted *but* the validity of the secu-

rity interest received is vulnerable and defective a
between the creditors of a manufacturer-seller and th
Entruster unless the *Entruster's security interest i*
predicated upon a prior valid sale to, and the actua
and continued change of possession by, the financed
purchaser being respectively Miller and Consolidate
in the pending appeal. To the same general effect se
In re San Clemente Electric Supply (D.C.-Cal.) 10
Fed. Sup. 252, and *Metropolitan Fin. Corp. v. Morf*
42 Cal. App. (2d) 756.

Two cases are cited in the *Chichester* decision, th
Arena and *Boswell* Cases mentioned above. The fact
of these cases were similar in that the Entruste
derived its title from the Trustee *who had both posses*
sion and valid title to the merchandise covered by th
Trust Receipt. Thereafter, the Trustee became bank
rupt and action was brought by the Entruster to re
claim the merchandise from the Trustee in Bank
ruptcy. The Entruster in the *Boswell* case was hel
entitled to claim the merchandise from the Trustee i
Bankruptcy unlike the result in the *Arena* case. Th
decision was based on the Sections of the Californi
Civil Code comprising the Uniform Trust Receipt
Law stating that the Entruster could obtain his secu
rity interest from anyone. It is to be noted in th
Boswell, Arena and *Chichester* cases that it was th
financed-purchaser that became bankrupt and the issu
was between *the creditors of the financed-purchase*
acting through his Trustee in Bankruptcy and the En
truster. It is to be noted also that in the *Boswell*
Chichester and *Arena* cases the financed-purchaser ha

possession of the property in each case. It is submitted that the crux of the matter is brought out in the *Chichester* opinion (page 443) where the Court notes the effect of the *Arena* case as follows:

> "Where the title of the entruster was derived from the trustee and not from some third person, the transaction was treated as being similar to a chattel mortgage and was held to be void as against creditors of the trustee in the absence of recordation."

The *Arena* case, decided in 1924, thus held that the transaction was void as against creditors of the trustee, the financed-purchaser. The Uniform Trust Receipt Law, thereafter enacted in California, changed this result by permitting the Entruster to receive his title from anyone. Therefore, the security interest of the Entruster, no matter from whom received, now is valid as against *creditors of the trustee or financed-purchaser*. There is no logical reason for reading into this section that it was intended to make the receipt of such title by the Entruster good and valid security interest as against the creditors of the manufacturer-seller and also the financed-purchaser where a valid sale and the requisite change of possession was never consummated initially between the manufacturer-seller and the financed-purchaser. It is submitted that the *Chichester* decision is limited to the facts as set forth in that case and that the security interest of the Entruster is valid under those facts only as against the creditors of the financed-purchaser. The decision should not be extended, nor does it indicate, that the

security interest of the Entruster is valid as against the creditors of the manufacturer-seller.

Civil Code Section 3014 (3) which reads in part as follows *required Consolidated to have possession* of the scrapers:

> "A transaction shall not be deemed a trust receipt transaction unless the *possession* of the trustee thereunder is for a purpose substantially equivalent to any one of the following:
>
> (a) In the case of goods, documents or instruments for the purpose of selling or exchanging them, or of procuring their sale or exchange;"

The importance of the necessity of possession by Consolidated, the financed-purchaser, in a Trust Receipt transaction is again brought out in *Moore v. Bank of America National Trust & Savings Association* (9 CA) 96 Fed. 2d 239 at page 241 where this court said:

> "The essential character of the 'trust receipts' has long been understood by the Mercantile and Banking community. Such 'trust receipts' include the long-established method of securing mercantile loans by a transaction in which the lender, having no prior title in the goods, upon which the lien is to be given, and without having possession, *which remains in the borrower,* lends his money to the borrower upon the security of the goods, which the borrower is privileged to sell to clear the lien, he agreeing to pay all or part of the proceeds of the sale to the lender. The documents in which the transactions are expressed are known in the business of banking world as 'trust receipts'." (Emphasis added.)

n 13 California Law Review at pages 333 and 334 it said:

> "A trust receipt is a valid form of security, however, when used in the proper situation. The buyer arranges for a banker or other lender to pay the seller, the lender taking title. The documents of title are sent forward to the lender. *It then becomes necessary for the buyer to have the goods in his business* so they, or the documents that represent them, *are turned over to* him against a trust receipt which declares that the title remains in the lender until payment, *that the buyer takes possession as trustee for the lender,* usually for purposes of sale or manufacture." (Emphasis added.)

CONCLUSION.

Upon the foregoing argument and authorities, ppellant respectfully submits that the Bank of Amer- a cannot claim a valid security interest in the scrap- s as against the creditors of Miller. Consolidated aving been found to have no title or interest in the roperty, the security interest it purported to transfer the Bank must likewise fall and that portion of the der of the District Court adverse to Appellant should e reversed.

Dated, June 5, 1957.

Respectfully submitted,

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